Spanish banking crisis roils global financial markets

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Fears that the euro zone is nearing breakup sent panicked investors to safe haven assets Wednesday, driving the yields on US government debt to their lowest levels since 1946.

Investors fled from Spanish and Italian bonds after the European Central Bank made clear that it would not allow Spain to tap its financing to recapitalize Bankia, the country's fourth-largest bank, which last week requested a €19 billion bailout from the Spanish government.

In response to the ECB's statement, the Spanish government announced it would raise an additional €19 billion to bail out the bank.

Yields on Spanish 10-year bonds shot up 0.23 percentage points to 6.64 percent, bringing the country dangerously close to the 7.0 percent rates that forced Greece and Portugal to request bailouts from the European Union.

Borrowing costs for the Italian government rose to more than 6.0 percent for the first time this year, as Italy missed its goal of selling €6.25 billion in bonds. Italy's borrowing costs are now 4.65 percentage points higher than those of Germany.

Yields on German two-year government bonds briefly fell below zero for the first time ever, as investors actually paid the German government to borrow their money. Yields on German two-year bonds ended the day at 0.007 percent, down 0.04 percentage points for the day. Ten-year yields likewise hit a record low of 1.261 percent.

Bankia requested assistance from the Spanish government after Standard & Poor's downgraded it, along with several other Spanish banks, on Friday. Shares in the bank fell 8.6 percent Wednesday in the sixth consecutive day of losses.

Deposits at Spanish banks continued to erode. The total level of Spanish bank deposits fell by €31.44 billion, or 2.4 percent, to the lowest level since the start of the euro crisis.

The Bank of Spain announced Wednesday that its governor, Miguel Angel Fernández Ordóñez, would step down at the end of next week, a month earlier than had been previously announced.

The country was also hit with another downgrade Wednesday after the markets closed, when Egan Jones Ratings Co. downgraded the country's debt to B from BB-minus and gave it a negative outlook.

Stocks throughout Europe plunged on these developments. The Spanish Ibex fell 2.5 percent and the Stoxx Europe 600 index dropped 1.5 percent. US exchanges trailed the European sell-off, with the Standard & Poor’s 500 falling by 1.43 percent. The Dow fell 160 points, or 1.28 percent.

In the US, the stock sell-off was driven by companies with high exposure to fluctuations in global demand. Alcoa, the aluminum producer, fell 3.43 percent and Caterpillar, the maker of construction equipment, declined 2.5 percent.

The euro fell 0.8 percent against the dollar to $1.24, its lowest valuation in two years, as investors scrambled to buy up dollar-denominated assets as a safe haven.

Fears of a wholesale economic collapse in Spain along the lines of Greece, whose economy shrank 6.2 percent over the past year, led the European Commission to state Wednesday that it was "ready to consider" pushing back to 2014 its deadline for Spain to bring down its budget deficit to 3 percent of gross domestic product.

The organization, the executive arm of the European Union, also raised the possibility of forming a "banking union" that would allow it to collectively assist failing banks in member states, citing Spain as an example.

The debt turmoil comes amid growing signs of a renewed economic downturn. The Purchasing Managers’ Index for the euro zone fell at its fastest rate in three years, according to figures released last week, leading Markit, the index's issuer, to conclude that the euro zone economy will likely shrink by about 0.5 percent in the second quarter.

This followed the second-sharpest monthly contraction in German business confidence since the collapse of Lehman Brothers and the announcement by Britain that its economy shrank by 0.3 percent in the first quarter.

The consensus is emerging that the euro zone economy will contract this year, and that next year is likely to be even worse.

The growing debt crises in Spain and Italy raise the prospect that these countries, too, will soon be unable to raise money in the bond markets. While Greece and Portugal are relatively small, making up just 1.7 and 1.3 percent of the euro zone economy respectively, Spain and Italy account for 8.4 and 12 percent of the gross domestic product of the European Union.